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SURETYSHIP LAW AS AFFECTED BY THE RISE OF SURETY COMPANIES. — One of the peculiarities of the law of suretyship is the favor shown to the surety and the readiness with which he is released from his obligation. With the recent development of surety companies as a business enterprise the question is now frequently raised whether the same leniency will be shown toward sureties for profit. The Michigan court has decided that a corporate surety is not discharged by an extension of time given to the principal debtor by the creditor unless actual harm to the surety is proved. *People* v. *Traves*, 154 N. W. 130. A recent Missouri case held that stockholders who signed a note of the corporation as accommodation indorsers were not released by the surrender of security by the creditor to the corporation. *Mercantile Trust Co.* v. *Donk*, 178 S. W. 113.[1] The court argued that the indorsers as shareholders had received the whole benefit of the loan to the corporation for which the note was given, that they were thus sureties for compensation, to which the ordinary technical rules protecting accommodation sureties did not apply.

The great weight of recent authority agrees that sureties for profit should be treated differently from accommodation sureties, but it is not always made clear what defenses of the surety are affected by this

[1] For a more complete statement of these cases, see RECENT CASES, p. 342.

distinction. In regard to the construction of the surety's contract a difference in treatment is well established. The contract of the accommodation surety must be construed strictly, and doubts resolved in his favor.[2] But the contracts of sureties for profit are treated like insurance policies, and are construed most strongly against the surety.[3] This distinction is justified by the fact that while the accommodation surety usually has little to do with drawing up his contract, those engaged in suretyship business formulate their agreements themselves, hedging their liability about with numerous carefully calculated conditions and restrictions. One noticeable effect of this liberal construction is seen in cases involving the rule that the surety is discharged when his risk has been materially increased by any transaction between the creditor and the principal,[4] a defense which seems generally to be given to the surety for profit also.[5] The test here is a broad one and depends partly on what was contemplated by the parties. As a result of the broad construction of contracts of business sureties, this defense may often not be available in cases where it would give the accommodation surety a complete defense.[6]

The discharge of the surety by a binding agreement between the creditor and the principal for an extension of time, — which defense was denied to the surety for profit in the Michigan case, — is frequently said to rest on the principle that a variation of the contract between the cred-

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[2] City of Sterling *v.* Wolf, 163 Ill. 467, 45 N. E. 218; State *v.* Dayton, 101 Md. 598, 61 Atl. 624. Thus a change in the membership of a partnership absolutely discharges a surety for the partnership obligations. Byers *v.* Hickman Grain Co., 112 Ia. 451, 84 N. W. 500; Dupee *v.* Blake, 148 Ill. 453, 35 N. E. 867.

[3] American Surety Co. *v.* Pauly, 170 U. S. 133; Tebbets *v.* Mercantile, etc. Co., 73 Fed. 95; City of New Haven *v.* Eastern Paving Brick Co., 78 Conn. 689, 63 Atl. 517; Van Buren County *v.* American Surety Co., 137 Ia. 490, 115 N. W. 24; Brandrup *v.* Brazier, 111 Minn. 376, 127 N. W. 424; Rule *v.* Anderson, 160 Mo. App. 347, 142 S. W. 358; Bank of Tarboro *v.* Fidelity, etc. Co., 128 N. C. 366, 38 S. E. 908; Walker *v.* Holtzclaw, 57 S. C. 459, 35 S. E. 754; Cowles *v.* United States Fidelity, etc. Co., 32 Wash. 120, 72 Pac. 1032; United American, etc. Co. *v.* American Bonding Co., 146 Wis. 573, 131 N. W. 994. *Contra*, American Surety Co. *v.* Koen, 49 Tex. Civ. App. 98, 107 S. W. 938. See Lonergan *v.* San Antonio, etc. Co., 101 Tex. 63, 77, 104 S. W. 1061, 1067.

"Their business is in all essential particulars that of insurers, who, upon careful calculation of the risks of such business, and with such restrictions of their liability as may seem to them sufficient to make it safe, undertake to assure persons against loss, in return for premiums sufficiently high to make such business commercially profitable. Their contracts are, in fact, policies of insurance, and should be treated as such." Tebbets *v.* Mercantile, etc. Co., *supra*, 97.

[4] Village of Chester *v.* Leonard, 68 Conn. 495, 37 Atl. 397; Mayhew *v.* Boyd, 5 Md. 102; Fidelity Mutual Life Association *v.* Dewey, 83 Minn. 389, 86 N. W. 423. See Reese *v.* United States, 9 Wall. (U. S.) 13, 22. See BRANDT, SURETYSHIP AND GUARANTY, § 439. See 21 HARV. L. REV. 63; 16 *ibid.*, 511.

[5] An extension of time to the principal debtor, though not in itself a defense to the surety for profit, might be so great as to cause a material increase in the risk, and so discharge the surety on this ground.

[6] See, for example, United States Fidelity, etc. Co. *v.* Golden, etc. Brick Co., 191 U. S. 416; Atlantic Trust, etc. Co. *v.* Town of Laurinburg, 163 Fed. 690; People *v.* Bowen, 153 N. W. 672 (Mich.); Lakeside Land Co. *v.* Empire State Surety Co., 105 Minn. 213, 117 N. W. 431; Rule *v.* Anderson, 160 Mo. App. 347, 142 S. W. 358. In Young *v.* American Bonding Co., 228 Pa. St. 373, 77 Atl. 623, the surety for profit was discharged by a material increase of the risk. In Lackland *v.* Renshaw, 256 Mo. 133, 165 S. W. 314, the court seems to indicate that nothing but actual injury will discharge the surety for profit.

itor and the surety will release the surety.[7] But this defense is really equitable in its nature, based on the duty of the creditor not to interfere with the surety's equitable right of subrogation.[8] This is shown by the fact that the surety is discharged only if the creditor knew of the suretyship relation when he granted the extension; [9] though it is enough if he first learned of it after the contract with the surety was made.[10] This strict rule grew up at a time when the modern surety companies were unknown, in order to protect those who became surety from motives of charity.[11] It has often been criticised.[12] In ordinary cases the surety has no need for his right of subrogation; and this interference with it, which entirely discharges him, even if the extension is but for a day, does not cause him the slightest actual injury, since he is protected to exactly the same extent by his direct right of reimbursement against the principal. And it is submitted that in such cases all who engage in suretyship as a business venture should be required to prove actual prejudice before an extension of time will release them. A number of cases have reached this result,[13] but their reasoning is not entirely clear. They seem to say that as a matter of construction the surety's obligation is broad enough to cover the extension. If this were the explanation, it would be immate-

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[7] "At law it seems to have been thought that the discharge of the surety by such giving time to the principal was founded on a variation of the contract between the creditor and the surety." Pooley *v.* Harradine, 7 E. & B. 431, 433. Daneri *v.* Gazzola, 139 Cal. 416, 73 Pac. 179. See BRANDT, SURETYSHIP AND GUARANTY, 3 ed., § 376.

[8] Gibbs, C. J., in Orme *v.* Young, Holt, N. P. 84, 86: "This defense is borrowed from a court of equity: there, if day of payment be given to the debtor, the sureties are discharged. It is the equitable right of sureties to come into a court of equity and demand to sue in the name of the creditor. Now if the creditor have given time to his debtor, the surety cannot sue him." Samuell *v.* Howarth, 3 Meriv. 272; Pooley *v.* Harradine, 7 E. & B. 431; Peake *v.* Estate of Dorwin, 25 Vt. 28. See Polak *v.* Everett, 1 Q. B. D. 669, 673. See 12 HARV. L. REV. 426.

[9] Nichols *v.* Parsons, 6 N. H. 30; Kaighn *v.* Fuller, 14 N. J. Eq. 419.

[10] Oriental Financial Corporation *v.* Overend, Gurney & Co., L. R. 7 Ch. 142; Lauman *v.* Nichols, 15 Ia. 161. See BRANDT, SURETYSHIP AND GUARANTY, 3 ed., § 41. The same is true even though the suretyship relation itself did not arise until after both the principal and the surety became bound to the creditor. Rouse *v.* Bradford Banking Co., [1894] A. C. 586.

[11] "The deep solicitude of the law for the welfare of voluntary parties who bound themselves from purely disinterested motives never comprehended the protection of pecuniary enterprises organized for the express purpose of engaging in the business of suretyship for profit." Rule *v.* Anderson, 160 Mo. App. 347, 358, 142 S. W. 358, 362.

[12] Cockburn, C. J., in Swire *v.* Redman, 1 Q. B. D. 536, 542: "It has been settled by decisions that there is an equity to say that such an interference with the rights of the surety, — in the immense majority of cases not damaging him to the extent even of a shilling, — must operate to deprive the creditor of his right of recourse against the surety, though it may be for thousands of pounds. But though this seems . . . consistent neither with justice nor common sense, it has been long so firmly established that it can only be altered by the legislature." Blackburn, J., in Polak *v.* Everett, 1 Q. B. D. 669, 674: "Whether that was a good or a just principle originally, is a matter which it is far too late to think about now. I must own I have had considerable doubts about the justice of that principle."

[13] United States Fidelity, etc. Co. *v.* Golden, etc. Brick Co., 191 U. S. 416; United States *v.* United States Fidelity, etc. Co., 178 Fed. 721; United States *v.* United States Fidelity, etc. Co., 172 Fed. 268, 178 Fed. 692; People *v.* Bowen, 153 N. W. 672 (Mich.); Philadelphia *v.* Fidelity, etc. Co., 231 Pa. St. 208, 80 Atl. 62. *Contra*, United States *v.* American Bonding, etc. Co., 89 Fed. 925. In United States *v.* United States Fidelity, etc. Co., 172 Fed. 268, 178 Fed. 692, the principal debtor went into the hands of a receiver before the end of the extended period, but the surety was not discharged.

rial that the extension was actually prejudicial, yet it is said that this added fact would discharge the surety. It seems, therefore, that the courts have really modified the strict defense of extension of time, as applied to surety companies.

When the creditor has security, as in the Missouri case, or a preferred claim against the principal, the surety's right of subrogation has real value, and may enable him to recover a larger amount from the principal than he could through his right of reimbursement. Here an interference with the right of subrogation by an extension of time, or by a surrender of the security,[14] does cause the surety potential injury. But even in such cases the expediency of absolving business sureties from their obligations, without proof of actual damage, is at least an arguable question.

It is important to point out that the distinction in these cases is not between corporate and individual sureties, — as is often loosely stated,[15] — but between persons, natural or artificial, who make a business of suretyship, and those who do not. And it is conceived that one who, not in the suretyship business, occasionally assumed the obligation for a small compensation, should fall within the latter class and be entitled to all the defenses which are available to sureties generally.[16] In this respect, the Missouri court seems to have gone too far in applying the stricter liability of professional sureties to stockholders who go surety on a corporation note. For, assuming that the stockholders received compensation indirectly through the benefit to the corporation,[17] they were not engaged in suretyship as a business.

THE DACIA CASE. — The condemnation of this vessel by the French Prize Court involves an ancient problem of international law as to the validity of transfers of belligerent merchant ships to neutral ownership during hostilities, or in anticipation thereof. The Dacia was formerly owned by the Hamburg-American Line, a German company. After war broke out, the German owners offered the vessel for sale rather than that it should remain idle in an American port. It was accordingly bought in December, 1914, by a citizen and resident of the United States and transferred at once, under the Ship Registry Act of August 18, 1914,[1]

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[14] Pearl *v.* Deacon, 3 Jur. N. S. 879; Kirkpatrick *v.* Howk, 80 Ill. 122. BRANDT, SURETYSHIP AND GUARANTY, § 480. Thus the surety is discharged although the creditor first learned of the suretyship relation after the contract with the surety was made. Guild *v.* Butler, 127 Mass. 386. And it is immaterial that the creditor first acquired the security after the surety became bound. Holland *v.* Johnson, 51 Ind. 346; Plankinton *v.* Gorman, 93 Wis. 560, 67 N. W. 1128.

[15] See, for instance, Young *v.* American Bonding Co., *supra*, 228 Pa. St. 373, 380, 77 Atl. 623, 626.

[16] In the principal Missouri case, even admitting that the sureties did receive consideration, yet they were not engaging in the business regularly for profit, with the risks and conditions neatly calculated, and therefore should have been allowed the ordinary technical defense.

[17] This does not seem to involve a disregard of the corporate fiction as has been suggested. 16 UNIV. OF MO. BULLETIN, No. 34, p. 47. Whether benefit moved to the stockholders by a loan to the corporation is purely a question of fact.

[1] 38 STATS. AT LARGE, pt. 1, p. 698.